



Business Models and Selected Performance Metrics of Philippine Airlines and Cebu Pacific: An Exploratory Comparative Analysis

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Abstract - Philippine Airlines (PAL) and Cebu Pacific serve as the market leaders and the strongest competitors in the Philippine airline industry. The paper focused on determining the similarities and differences in the business models of PAL and Cebu Pacific representing full-service carriers (FSC) and low-cost carriers (LCC), respectively. The study evaluated and compared eighteen factors of the airline business model and selected performance metrics of PAL and Cebu Pacific. The two airlines differ in all the factors evaluated as they more or less in accordance with their original business models. However, PAL and Cebu Pacific have slightly adapted from each other's business models at some extent. Results showed that Cebu Pacific tends to deviate 77.78% from its original model. PAL, on the other side, had 94.44% conformity with its original model. From the results, "hybridization" that is used by LCCs is also manifested by FSCs and vice versa as shown in the cases of PAL and Cebu Pacific. It was seen that Cebu Pacific performed better than PAL in terms of profits, load factors, costs, and labor productivity from 2009-2013. Although both the airlines had modifications in their respective models especially in 2013, the sustainability of their decisions models will be manifested in the long run.

Keywords: airlines, business models, full-service carriers, low-cost carriers, performance metrics

INTRODUCTION

Through the years, the aviation industry around the world experienced certain developments including the reduction in trade barriers and industry regulations, and technological advancements. These developments had driven the introduction of low cost carriers (LCCs) as new players in the industry aside from the original full service carriers (FSCs).

The rapid growth of low cost carriers (LCCs) has increased the competitive pressures in the airline industry across the globe. By making air transport more convenient and less costly for travelers, LCCs have gained ground in different countries which were previously dominated by FSCs or the original airlines. Moreover, the threat that the LCCs posed to FSCs and vice versa has brought about a revamping of their existing business models.

Business model is defined the as "a conceptual tool containing a set of objects, concepts and their relationships with the objective to express the business logic of a specific firm." [16]. Thus, the business model served as a "blueprint" or building plan of how a company does business. This is similar to definition of business model as the "stories that explains how enterprises work" [17].

The revamping of existing business models includes the different strategies and activities that the airlines employed in their operations and value propositions to capture their target customers. This trend can also be seen in the Philippines in the case of Philippine Airlines (PAL) and Cebu Pacific, representing the FSCs and LCCs, respectively.

Similar to that of other regions, deregulation in the air transport industry in the Philippines opened the doors to low cost



carriers. There are now five airlines with international routes- Philippine Airlines, Cebu Pacific, ZestAir, SeaAir, and AirPhil Express. As for domestic routes, the same airlines provide air travel services with the addition of AirAsia [1].

Through the years, with more liberalized air travel regulations or restrictions and the rise of the LCCs, demand for air travel continued to grow rapidly. In the Philippines, the air transport market grew by approximately 50% in 2011 from 2008 with more than 50 million passengers in the Philippine airports [2]. In the domestic market, PAL and Cebu Pacific dominated the other airlines in terms of their capacities. From being the dominant entity in the market for decades, PAL is now faced with multiple competitors. In 2003, PAL's market share was at 53% while Cebu Pacific gained 30% in general [2].

As low-cost carriers continued to fare well in the industry, full-service carriers had to reinvent their business models to maintain their business position. FSCs incorporated some actions of LCCs which included among others, minimizing costs by modernizing fleets, eliminating complimentary services and so on. In response, LCCs also adjusted their strategies with that of FSCs to increase their customer base, increase competitiveness and create long term sustainability. LCCs introduced more products and services, and more flight destinations, among others. The business models of both airlines became a fusion of the business frameworks of the original FSC and LCC [3]. In contrast, the modification of the LCC model indicated a shift from a strategy of cost leadership to one that incorporates product and service differentiation.

The paper analyzed the business models being employed by airlines in the Philippines with an emphasis on Philippine Airlines and Cebu Pacific, representing the FSCs and LCCs in the Philippines, respectively. In addition, the performance of PAL and Cebu Pacific through the years was evaluated based on selected performance metrics conventional in the airline

industry to determine the effect of their respective models and strategies. The carriers' conformity with their respective "original" models was assessed considering the changes in the general performances of PAL and Cebu Pacific.

OBJECTIVES OF THE STUDY

This study generally aims to compare the business models of Philippine Airlines (PAL) and Cebu Pacific. In particular, this study intends to determine whether there are similarities and differences in the business models of PAL and Cebu Pacific and what these similarities and differences are. It also aims to find out how these business models differ from that of the original models of FSC and LCC and their effects on the performance of PAL and Cebu Pacific.

RESEARCH METHODOLOGY

This study compared the business models of PAL and Cebu Pacific Air, the representative FSC and LCC in the Philippines, respectively. The research was mainly descriptive which analyzed and discussed qualitatively and quantitatively, the various components of the business models of PAL and Cebu Pacific. In particular, the study contained qualitative data regarding some of the factors of the airlines' business models. These included the products and services offered, the target segments, distribution channels, and seating and fare policies. The nine building blocks of business model as compiled by Osterwalder et al. [16] will be used as the main conceptual framework of this study.

The data collected in this aspect was nominal in nature indicating that information was categorized in the different areas mentioned earlier. It facilitated the descriptive portion of the comparison of the business models of PAL and Cebu Pacific and the original LCC and FSC models.

The quantitative part of the study included an analysis regarding the cost and revenue structures of PAL and Cebu Pacific



which were measured using some key airline metrics. Ratio level data was included since cost and revenue drivers are indicated to be integral in determining the full service or low-cost nature of different airlines. The comparison of PAL and Cebu Pacific business models provided an understanding of the similarities and differences of their business models, in what areas they were similar or different, and which airline was performing better in a particular business model category. Included also is an analysis of the level of conformity and deviation of each airline with their respective “original” business models.

As indicated, the research utilized building blocks by Osterwalder [4] as general guides which were made more specific with the incorporation of airline specific components from Chowdhury [5] to capture the nature of the said industry. However, to further operationalize the four pillars and their distinct component factors, a table was constructed to indicate the specific data to obtain.

The study also assessed the factors in which PAL and Cebu Pacific conformed or deviated to/from their respective original business models. This section of the analysis utilized the method used by Alamdari and Fagan [6] wherein points were subjectively assigned depending on whether the airlines conformed or deviated from the original business models. Two points are given to the factor or feature that is completely identical to the original model. One point is assigned if the airline possessed a similar feature from the other type. Lastly, zero is assigned if the airline has completely different feature from the original model.

For example, two points is assigned in the route structure if PAL still operates in a hub-and-spoke model. If PAL operates in a mixture of characteristics of hub-and-spoke and point-to-point, that feature under PAL is given one point. Lastly, if it fully deviated from the original which means that it operates in a pure point-to-point network, it will be given a zero. On the other hand, if Cebu Pacific operates in a point-to-point network, the route structure factor is assigned two points. If Cebu Pacific operates in

a mixture of point-to-point and hub-and-spoke, one point is assigned and if it operates in a pure hub-and-spoke network, zero is assigned in the route structure factor. The basis of the scores will be a score sheet of airlines that completely conformed to the original models where two points were assigned in all the factors of the business model. To find the percentage of conformity or deviation, the total number of points is indexed to 100. For each airline, the maximum points that can be assigned is 36 points which is gained from multiplying 18, the number of features, and the maximum score which is 2. The airline with 36 points means it has 100% adherence to its original model. The minimum point that can be given is zero, if the airline fully deviated from the original model. The higher the total number of points, the more the adherence of the airline to the original business model. Conversely, the lower the points assigned to an airline, the more the deviation from the original model which could indicate hybridization. For example, if an airline had 24 points, it adhered to the original model by 66.67% based on 24 over 36 (maximum points).

The data used in this study are mainly centered on the information gathered relating to PAL and Cebu Pacific. With regard to the descriptive portion of the business models and operations of the airlines, the most recent information regarding the airlines is used. The financial data used in the study spans from the years 2009-2013.

The above secondary data were collected from the different government agencies and regulatory boards of the airline industry such as the Civil Aeronautics Board (CAB), the Centre for Aviation (CAPA), and The International Air Transport Association (IATA). Aside from this, information is also sourced from the different website, financial statements, Securities and Exchange Commission (SEC) forms of PAL and Cebu Pacific. After collecting the data, these are collated according to the proposed categorization of the business model factors indicated earlier.



RESULTS AND DISCUSSION

The following table summarizes the results from the analysis of business model building blocks. The 3rd and 5th column show the points which were assigned, whether the airlines conformed or deviated from their original

model. Two points are given to the feature that is identical to the original model. One point is assigned if the airline possessed a similar feature while zero is assigned if the airline has completely different feature from the original model.

PAL and Cebu Pacific's Business Model

Philippine Airlines			Cebu Pacific	
PILLAR	Results	Points	Results	Points
Pillar 1: PRODUCT				
Fares	Bundled products and services in a base fare Higher prices	2	Unbundled products and services with extra charges for optional services Lower prices	2
Route structure	Hub-and-spoke	2	Mixture of hub-and-spoke and point-to-point network	1
Seating policies	Reserved/pre-assigned seating; multiple class passengers	2	Free seating; single class passengers	2
With in-flight services	Yes. With free complimentary service	2	Offers services but with extra charges	2
Frequent flyer program	Yes: Mabuhay Miles	2	Yes. Through credit card partnerships that enable customers to earn points.	1
Pillar 2: CUSTOMER INTERFACE				
Target customer	Higher end	2	Price-sensitive consumers	2
Relationship	Differentiated products	2	Value proposition of lowering costs	2
Distribution channels	Multichannel distribution systems (i.e. direct and indirect)	1	Multichannel distribution systems but high sales from direct channels (i.e. through internet booking)	2
Pillar 3: INFRASTRUCTURE MANAGEMENT				
Type of aircrafts	Multiple aircraft fleet families; narrow to wide-body aircrafts	2	Four fleet families including wide-body aircrafts	1



Utilization of aircrafts	6 hours per day	2	12.5 hours per day	2
Aircraft turnaround time	45 minutes	2	30 minutes	2
	Slower turnaround time		Faster turnaround time	
Trip length	Short to long haul flights	1	short to long haul flights	1
Airport operations	Uses primary airports	2	Uses primary airports	0
Staff features	Less productive labor	2	More productive labor	2
Core Competency	Provision of services and increasing revenue	2	Can lower costs	2
Partner Network	Partnerships, Interline arrangements and Code sharing	2	Equity stake and alliance with TigerAir (i.e. limited code share and interlining)	1
Pillar 4: FINANCIAL ASPECT				
Cost structure	Higher operating costs per unit than Cebu Pacific	2	Lower operating costs per unit than PAL by 10-40%	1
Revenue model	Higher revenue compared to Cebu Pacific	2	Lower revenue than PAL but a high percentage from ancillary revenues	2
Percentage of Conformity	34/36 = 94.44%		28/36 = 77.78%	

Sources: Building blocks and pillars; [4] Analyzed from website [12] [14] & SEC forms [13] [15]

As the table above shows, PAL conformed to the original FSC model by 94.44%. The deviation of PAL from the original model is just 5.56%. On the other hand, Cebu Pacific has 77.78% conformity with the original LCC model. Based on the above evaluation, Cebu Pacific tends to have deviated more from the original model by 22.22%. This may imply that the business models of PAL and Cebu Pacific have nearly become similar which further indicates that Cebu Pacific is starting to resemble the business model of PAL.

Philippine Airlines

Based on the findings, PAL has a closer conformity to the original FSC business model as indicated by 94.44% rating. In the past, PAL employed changes in its business model with the

establishment of an LCC subsidiary which is one form of “hybridization”. It seemed that PAL was following this trend for FSCs when it created AirPhil Express as its low-cost airline in 2010. During this time, PAL experienced a net income of Php 187, 421 as compared to its PHP 12 million loss in the previous year. Primarily, both the revenues and operating expenses of PAL decreased in 2010. The possible reasons for this would be the decrease in its fuel expenses, and the reduction in its employees by 7% leading to lower personnel cost.

In 2011, AirPhil Express as an LCC subsidiary of PAL was in full swing. This enabled PAL to target the lower income or more price sensitive segments in the Philippine market. It is notable that in this year, PAL jacked up its average prices to approximately



Php 7,000 and its average price per kilometer to Php 3.14. Since AirPhil Express serviced the price sensitive passengers, PAL was able to focus on the upper segments who can relatively afford this price level. This resulted to higher passenger revenues for PAL. Even though coupled with higher operating expenses, PAL yielded a Php 2.9 million net income. In the following years, even though PAL's price increased, its yields rose as well.

For the following year, the PAL Group underwent a change in management wherein San Miguel Corporation took ownership of the airline [7]. With the ownership change, the new influx of capital enabled PAL to push and expedite its fleet renewal program which included the procurement of 100 aircrafts to be delivered between 2014 and 2016. Also during this time, PAL was able to increase its fleet size with more efficient Airbus 320s.

Although the AirPhil Express venture was performing well in the domestic market, the airline was seen to be "cannibalising" the domestic operations of PAL within the LCC's three year span [9]. In 2012, AirPhil Express took over some of the routes that PAL offered. Thus, despite PAL's supposed increase in fleet size and capacity, PAL experienced a decrease in its passenger traffic, based on total passengers flown and revenue passenger kilometer (RPK), and capacity as measured in available seat kilometers (ASKs). PAL's passenger load factor also decreased within this period which can be attributed to the growing capacity and size of LCCs including Cebu Pacific. Although PAL was affected by its subsidiary, it also benefitted by targeting more customers, defending its market share, and acquiring passengers away from PAL's competitors.

Supposedly, AirPhil Express was set to compete with the first long haul flight of Cebu Pacific in the Middle East in 2013. As mentioned, earlier, the PAL Group operates with two brands with its FSC operations and its LCC subsidiary. However, the new management of PAL adjusted its two brand strategy by reverting the airline back into an FSC only. This decision

was visibly seen with the removal its offshoot LCC. AirPhil Express was rebranded as PAL Express and was transitioned back to an FSC only to serve thinner and less profitable domestic flights in the Philippines due to its lower costs while offering complimentary services usually seen in FSCs. Instead, PAL intended to focus on the international market instead (CAPA, 2013).

PAL's exit in the budget sector was seen to be an unfavorable move which would result to financial losses and loss in market share [9]. Based on the data on PAL's performance, PAL suffered a loss in its domestic share in 2013. This could be due to the reduced domestic routes of the PAL Group and the transformation of PAL Express. The decreased visibility of PAL on domestic flights and its higher fares led to the decline its market share from 41.5% to 34.1%. PAL's market share was not only absorbed by Cebu Pacific but also the other carriers in the Philippines including AirAsia Zest and SeaAir.

By focusing on being an FSC, PAL solidified its market to the upper segment of passengers which represents a small proportion of the Philippines [8]. Moreover, since services for in-flight, baggage, and comfort seating, are not essential for shorter haul flights, the increase in price that these services contributed to ticket prices may not be worth it for the large proportion of price sensitive passengers in the Philippines. It could be surmised that the loss of PAL's domestic market may not be recovered again [9].

Cebu Pacific

In the case of Cebu Pacific, it has introduced certain changes in its business models that indicated its deviation in recent years from the original LCC business model. This may explain the 77.78% conformity to the original LCC model. Cebu Pacific, as compared to PAL, has initiated more changes in its business models which resulted to its improved products, connectivity, and capacity. Most especially, a lot of changes in Cebu Pacific



occurred in 2013 which would have spill-over effects in the coming years.

From 2009 to 2013, Cebu Pacific experienced growth in its passenger revenues and total revenues. It was in 2010 when Cebu Pacific achieved the highest profit amounting to Php 6.9 Billion. During this time, Cebu Pacific was able to service more passengers even with a higher average price. Consequently, this led to a higher yield of Php 2.78 for each seat sold. In the following years, although the revenues of Cebu Pacific increased, its net income continued to diminish primarily due to higher operating expenses from fuel which affected all airlines especially LCCs [10]

Since 2009, Cebu Pacific not only introduced more routes in the domestic market but also envisioned to expand its international networks. In 2012, Cebu Pacific saw room for growth in the international market and thus positioned itself for the long-haul segment. It already ordered a new fleet of wide-body Airbus 330 aircrafts while expanding its other fleets. By introducing more destinations and routes, and expanding its fleet size, a year-on-year increase of 16.04% on average occurred in its capacity as measured in ASKs. Moreover, its RPK continued to rise too. However, the downside was that the too rapid expansion led to the excess or unused capacity of the airline wherein its load factor decreased in 2012 to 82.60% as compared to 86.30%.

In 2013, Cebu Pacific was able to secure a large market share in the domestic market amounting to more than 50% of the total passengers flown in the Philippines. Consistently through the years, Cebu Pacific has increased its market share especially when PAL and PAL Express lessened their visibility in the domestic market. Another reason for Cebu Pacific's increased market share is the lowering of its average fares since 2011. Although this tended to drive down the yields of Cebu Pacific's flights, it also increased the airlines passenger volume.

Since Cebu Pacific had a strong hold on the domestic market, it ventured into its first

long haul flight in the Middle East [11]. Supposedly, AirPhil Express was going to compete with Cebu Pacific in this segment but later withdrew its plans, as discussed earlier. With more destinations served, a bigger fleet, and lower prices, Cebu Pacific attracted more passengers which resulted to higher revenues. Moreover, the ancillary revenues of Cebu Pacific increased by 13.25% which reinforces that for longer flights, customers are willing to pay for additional services for their comfort and convenience.

In summary, both PAL and Cebu Pacific employed changes in their business models that may have affected their performance from 2009-2013 and which would spill-over in the coming years. Specifically, PAL appeared to "hybridize" with its LCC subsidiary but eventually under new management, changed its two-brand strategy with its exit in the budget sector and focusing on the core competencies of a typical FSC which are premium products and international services. This could explain its higher conformity to the original model at 94.44% and its decline in the domestic market. Even though it has a high similarity to a typical FSC, PAL strived to lower its costs.

Cebu Pacific had a lower conformity to the LCC model at 77.78% which was explained by the numerous changes it has incorporated in its business model especially when it comes to the aspects that increase the comfort, convenience, and accessibility of their products and services. This would include the improvement of their in-flight and pre-flight services, increased destinations, more accessible routes and airport of operations among others. By modifying its business model, Cebu Pacific seems to have a better performance compared to PAL which may be because it is able to service more customers while still offering relatively cheaper products.

CONCLUSION AND RECOMMENDATION

In the Philippine airline industry, PAL and Cebu Pacific could probably be considered as the market leaders with higher passenger



volumes, capacities, routes, and area of operations. Although these airlines are the most dominant Philippine carriers, they employ different strategies as depicted in their business models. PAL utilizes a differentiation strategy with the provision of premium services as seen in full service carriers. On the other hand, Cebu Pacific, one of the LCCs in the Philippines, uses a cost leadership strategy through lower operating costs passed off as lower flight fares.

In the past, PAL was the sole carrier in the Philippine airline industry. However, in the succeeding years, Cebu Pacific emerged as PAL's major competitor, amassing a high market share in both the domestic market of the Philippines and also the international arena. Though PAL and Cebu Pacific are employing different strategies, both the airlines became dominant carriers in the Philippines. PAL had a stronger hold on the international market while Cebu Pacific grew significantly in the domestic market. With the increased pressure of competition from each other and other carriers both foreign and local, PAL and Cebu Pacific employed certain changes in their business models. Based on the analysis, it showed that PAL's conformity to the original FSC model was 94.44% while Cebu Pacific had a lower conformity to the LCC model with 77.78%. It was noted in this study that both airlines tended to deviate the most from the original airline business models in the aspect of infrastructure management. This pillar depicts the structure of the operations of the airlines. Specifically, Cebu Pacific changed in terms of its type of aircrafts, trip length, airport operations, and partner networks. PAL also evolved in its trip length by offering short haul flights.

Although the changes are not necessarily deviations from the original business models, it influenced the airlines' performance. For PAL, its re-fleeting programs and more long-haul segments have increased its capacity. However, the most notable change for PAL was its low-cost subsidiary. And yet, with the transition of AirPhil Express into PAL Express, an FSC, PAL lost some of its share in the

domestic market which according to some airline analysts cannot be recovered [9]. With the reversion of this particular change in PAL's business model and its focus on international markets, PAL could be seen to be transitioning back to an FSC. However, PAL is expected to face more challenges in the future with its loss in the domestic market and the increased competition in the international airline industry from Philippine LCCs including Cebu Pacific and foreign carriers.

In comparison, by employing a low-cost strategy in earlier years, Cebu Pacific is able to gain ground in the airline industry and become a market leader in the Philippines. Nevertheless, changes in the business models of Cebu Pacific occurred more in 2013. Thus, the variations in its operations and improvements in its products, services, routes, and programs will more likely take effect in the coming years.

Both PAL and Cebu Pacific inculcated changes in their business models from 2009 to 2013. However, PAL's changes seemed to move back to the original FSC business model. On the other hand, Cebu Pacific is implementing more modifications in its models which deviates it from the original LCC business model. The effects of these reversions and deviations of PAL and Cebu Pacific respectively would be seen in their performance in more recent time periods.

To sum up, the study concludes that PAL and Cebu Pacific were found to be similar in terms of the trip length as both operates with short to long haul flights. The airlines are also similar in terms of types of aircrafts used as both used multiple types of aircrafts and also in airport operations as they use primary airports only. Additionally, both airlines also use multiple distribution channels which are in direct and indirect channels. They differ in all other factors mentioned above as they stick to their original business models which are completely opposite from each other, or they adapted their competitors' business model. PAL slightly adapted from Cebu Pacific business model such as in distribution channels (offering



tickets through internet) and trip length (offering short-haul flights). On the other hand, Cebu Pacific has sort of adapted PAL's business model in terms of route structure (operates in hub-and-spoke network), frequent flyer program (through credit cards), types of aircrafts (multiple fleets), trip length (offering long-haul flights), partner network (interlining) and cost structure (starting to differentiate thus the cost difference is now lower than 50%). With this, Cebu Pacific has deviated more from its original model with 22.22% than PAL with just 5.56% deviation from the original.

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